



Agenda Date: 03/15/01
Agenda Item: LSB

STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102

ENERGY

IN THE MATTER OF THE PETITION)
OF SOUTH JERSEY GAS COMPANY)
TO (1) REVIEW ITS LEVELIZED)
GAS ADJUSTMENT CLAUSE, (2))
REVIEW ITS TEMPERATURE ADJUST-)
MENT CLAUSE, AND (3) IMPLEMENT)
THE QUARTERLY LGAC PROVISIONS)
OF ITS RATE UNBUNDLING STIP-)
ULATION)

DECISION AND ORDER

DOCKET NOS. GR00050293,
GR00050294

(SERVICE LIST ATTACHED)

BY THE BOARD:

By Order dated November 16, 2000 ("November 2000 Order") the Board of Public Utilities ("Board") approved, on a provisional basis, subject to refund and interest, an increase in South Jersey Gas Company's ("Petitioner") Levelized Gas Adjustment Clause ("LGAC") billing factor, including sales and use tax ("SUT") from \$0.1134 per therm to \$0.2761 per therm effective on and after the date of the November 2000 Order. The Board also approved the implementation of Petitioner's Flexible Pricing Mechanism ("FPM") through April 2001, limiting monthly price increases to \$0.0204 per therm, including SUT, subject to further Board decision following hearings to be held before the Board during January 2001, addressing three issues recalled from the Office of Administrative Law ("OAL") in the matter of Petitioner's request to adjust its LGAC factor for the year 2001, namely: (1) the level of rates necessary for Petitioner to recover its prudently incurred gas costs; (2) Petitioner's flexible pricing proposal; and (3) Petitioner's proposed separate recovery clause for prior under-recovered gas costs. By Order dated December 6, 2000, the Board issued a modification of the November 2000 Order to make it clear that issues relating to pipeline supplier refunds, balancing service revenues and Petitioner's temperature adjustment clause were to remain at the OAL.

The November 2000 Order directed Petitioner to: (1) file testimony and various documentation and information with the Board by December 1, 2000, which was to be the subject of the January 2001 evidentiary hearings; (2) continue to make quarterly submissions providing, inter alia, updated cost information and Petitioner's future gas purchase plans; and (3) initiate actions to ensure that the customer impact of rising costs be mitigated to the extent possible. Responsive comments and testimony were to be filed by December 15, 2000. The November 2000 Order stated that, following the hearings, the Board would address whether the FPM would continue beyond January 31, 2001, and whether modifications to the mechanism should be implemented.

Consolidated hearings on this matter and the LGAC petitions of Public Service Electric and Gas Company, New Jersey Natural Gas Company and Elizabethtown Gas Company were conducted before Commissioner Frederick F. Butler on January 11, 12 and 16, 2001. In addition, a public hearing on Petitioner's matter was noticed and held in Voorhees, New Jersey on January 24, 2001 to further explain the basis and need for the relief sought by Petitioner. Initial and reply briefs were originally scheduled to be submitted to the Board by January 23, 2001 and January 26, 2001, respectively.

By letter dated January 17, 2001, the Division of the Ratepayer Advocate ("RPA") requested that the Board allow the RPA to file additional surrebuttal testimony, conduct an additional day of evidentiary hearings and extend the briefing schedule. The RPA noted that no party objected to the implementation of provisional rate increases for the months of February, March and April 2001. By letters dated January 19, 2001, Petitioner and other affected gas utilities responded to the RPA's request, opposing additional surrebuttal testimony and the scheduling of an additional evidentiary hearing, but not opposing the request for a reasonable extension of the briefing schedule, provided they would be permitted to extend the provisional monthly flexible pricing mechanisms authorized by the Board through April 2001. The utilities also asked that the Board permit, on a provisional basis, the recording of interest on their under-recovered LGAC balances effective February 1, 2001. By letter dated January 19, 2001, Commissioner Butler denied the RPA's request for the additional submission of surrebuttal testimony and the scheduling of an additional hearing date, but granted an extension of time for the submission of initial briefs until January 30, 2001, and for the submission of reply briefs until February 6, 2001.

By Order dated January 31, 2001, the Board affirmed the rulings of Commissioner Butler denying the RPA request for additional time for surrebuttal testimony and the scheduling of an additional hearing date, and granting additional time for submission of briefs and reply briefs from the parties. The Board declined to grant Petitioner's request to extend the provisional FPM through April 2001, but found the continuation of Petitioner's FPM through February 2001, subject to refund, to be both reasonable and necessary, and in the public interest, and so ordered. The Board also determined that it would address Petitioner's request to record interest on its under-recovered LGAC balances as well as other issues pending before the Board in this proceeding after review of the complete record.

By Order dated March 1, 2001 the Board extended Petitioner's provisional FPM through March 2001, subject to refund and interest, pending its final review of the full record of these proceedings without modification of its terms, noting that the high gas prices existing at the time of its November 2000 Order had not abated, and that even with an extension of Petitioner's current FPM authority through April 2001, gas cost under-recovered balances at the end of the current LGAC year may exceed \$68 million. The Board further ordered that, in order to continue to mitigate the impact of rate increases on customers, Petitioner should continue its consumer education and outreach efforts and continue to implement the additional mitigation measures set out in its November 2000 Order. Settlement discussions were conducted during the months of February and March. However, Petitioner and the RPA were unable to reach agreement on all aspects of Petitioner's request.

At the consolidated January hearings in this matter, Petitioner presented the testimony of David Kindlick and Jeffrey DuBois supporting its request that the Board decide to set the increases provisionally granted in November 2000 as the final LGAC billing factor for the current LGAC year together with the 2% FPM increases allowed at that time through April 2001, and additionally to extend the FPM through July 2001. Petitioner further proposed extending the FPM from December 2001 through July 2002 so as to provide rate flexibility for the 2001-2002 LGAC year as well, or alternatively, proposed the establishment of a quarterly LGAC mechanism with the first rate change under this mechanism to become effective on December 1, 2001. Petitioner also proposed that interest should be permitted on deferred fuel cost balances on the ground that the Board's decision to avoid "rate shock" by limiting recovery of the current unprecedented high gas costs provided a needed benefit to consumers, but placed the GDCs in the position of incurring millions of dollars in carrying costs which they should reasonably be allowed to recover. Petitioner estimated that, based on the January 5, 2001 NYMEX, even if the FPM is extended through July 2001, carrying costs on its underrecovered gas cost balance for this LGAC year may be \$2.7 million. Petitioner proposed that the interest rate on the underrecovery be set at 6.58%.

The RPA, while acknowledging in its reply brief that the Board's "phased" approach, i.e., permitting up to 2% increases per month through April, was appropriate, nevertheless objected to any continuation of the FPM through July or to permitting any further automatic increases during next fall and winter without new filings and evidentiary hearings for the next LGAC period. The RPA asserted that any further increases should be ordered only after the utilities have demonstrated that there will be a need to avoid large underrecoveries by the end of the next LGAC year and have also demonstrated that all appropriate measures have been taken to assure reasonable and stable prices for next winter. The RPA further objected to allowing interest on underrecoveries, noting that the utilities are not "entitled" to recovery of interest, either under Board rules, or as a matter of law, and that there is no basis for awarding interest where, as the RPA contends occurred here, the utility has not taken all possible "reasonable and prudent measures" to protect its ratepayers against the risk of excessive wholesale energy prices. Additionally, the RPA objects to any approval of the hedging program submitted in response to the Board's November 2000 Order, noting that Petitioner's filing consisted of a one-page description that was not sufficient to comply with the Board Order to provide information on parameters to be used nor on "triggers" or associated costs. The RPA asserts that clearly defined hedging objectives and parameters should be developed for each of the utilities after review by Staff, the RPA and other interested parties. Petitioner disputes RPA's characterization of its gas procurement activity, claiming that its hedging policy resulted in significant savings this year.

Discussion and Findings

The Board has carefully reviewed the filings and testimony of the parties. Based on the extraordinary rapid run-up of gas prices and the magnitude of the potential underrecovery of gas costs, the RPA has not objected to setting this year's LGAC factor at the rate set out in the November 2000 Order and has also acknowledged that continuation of the FPM through April is

appropriate. The latest figures submitted by Petitioner, taking into account the March 9, 2001 NYMEX figures, indicate that gas costs have not significantly abated and that even after extension of the FPM through April there may be an underrecovery at the end of the LGAC year of \$63 million. It further appears, based on available information, that extension of the FPM through July 2001 will not yield gas rates that exceed Petitioner's gas costs. The Board has therefore determined that setting the 2000-2001 LGAC billing factor at the rates set out in the November 2000 order and continuing the controlled monthly increases (or, if applicable, decreases) through July 2001, under the terms set for Petitioner's FPM by the November 2000 Order, is both reasonable and necessary as a way to limit the unprecedented anticipated underrecoveries and so ORDERS. The LGAC billing factor set for July will remain constant until such time as the Board may modify the terms of this Order, subject to true-ups at the end of the LGAC period. The Board notes that Petitioner's LGAC costs remain subject to audit by the Board, and that the Board's decision in this matter shall not preclude or prohibit the Board from taking any actions deemed appropriate as a result of any such audit.

With respect to the issue of interest on underrecoveries, Petitioner has asserted both a constitutional and a statutory right to recover its carrying costs for the underrecovered gas costs, relying on N.J.S.A. 48:3-58(u), which mandates that a utility providing basic gas supply service (BGSS") shall be permitted to recover in its charges for this service "on a full and timely basis all reasonably and prudently incurred costs incurred in the provision of [this service]...". Petitioner also notes that there have been occasions when the Board has permitted the recovery of carrying charges. Petitioner disputes the RPA's allegation that more could have been done to mitigate the impact on consumers when the steep rise in gas prices occurred, asserting that the RPA was attempting to retroactively impose a standard for hedging and other mitigation practices. In response, the RPA points out that there is no constitutional right to 100% recovery of specific expense items, citing Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) where the Supreme Court held that state regulators are not required to follow any specific ratemaking methodology, provided that the overall impact of any ratemaking decision is reasonable. The RPA further notes that N.J.S.A. 48:3-58(a) should not be interpreted to negate or alter the Board's longstanding policy, embodied in its regulations, not to permit interest on underrecovered LGAC balances.

With respect to the impact of N.J.S.A. 48:3-58(u) on the issue of full recovery of costs, including interest, the Board notes that this subsection as well as subsection N.J.S.A. 48:3-58(r), clearly contemplate ratemaking determinations by the Board for Basic Gas Service Supply ("BGSS") customers consistent with general ratemaking principles, and should not be interpreted to require recovery of interest inconsistent with Board practice. Thus, the utility is entitled to a reasonable return of costs consistent with the statutory goal, expressly stated as having the Board approve pricing mechanisms that encourage a gas supplier "to procure a portfolio of gas supply that provides maximum benefit to basic gas supply service customers." In this regard, the Board notes that historically the LGAC process has provided an advantage to utilities by enabling the annual recovery of any increase in current gas costs without the necessity of a full base rate case. Recovery is set based on estimates and information provided by the utility and it is the utility's responsibility to make the estimates as accurate as possible. Over the last year, however, there has been a rapid unanticipated and unprecedented rise in wholesale gas costs where prices have averaged about \$8.90 a dekatherm in recent months, more than three times what they were 18 months ago. For this reason, some sharing of the carrying costs for this year's unprecedented underrecoveries is reasonable.

The Board has therefore determined that the extraordinary circumstances prevailing in this case warrant a limited waiver of N.J.A.C. 14:3-13.4, the Board rule requiring payment of, interest on overrecoveries but disallowing interest on underrecoveries of LGAC costs. The Board notes that the rule was expressly designed to set a "generic policy" to discourage overestimation of gas or other costs by the utilities, as well as to set a uniformly calculated rate of interest for overrecoveries, equal to the Board - authorized rate of return for each company. See, 28 N.J.R. 4079. The present situation, with unprecedented large rapid increases in gas costs, recovery of which has been deferred by Board Order in order to avoid rate shock for consumers, was simply not anticipated when the rule was promulgated in 1996. This clearly constitutes a special case, justifying a limited waiver of the rule, pursuant to N.J.A.C. 14:1-1.2, so as to secure a just determination of this year's LGAC proceeding.

The Board therefore ORDERS that simple interest at the rate of 5.5% per year may be accrued by Petitioner on underrecovered gas costs commencing on April 1, 2001 on a monthly basis and continuing through October 31, 2001. The underrecovered gas cost amount as of that date, plus any accrued interest at the 5.5% rate will then be established as a Gas Cost Underrecovery Adjustment ("GCUA") surcharge to be collected commencing December 1, 2001 over an extended amortization period of three years from that date, with simple interest at 5.5%, until November 30, 2004. The Board notes that, by this Order, no interest is being allowed on any gas cost underrecoveries except for the seven designated months and then only to any accumulated underrecoveries as of October 31, 2001 and that the interest rate allowed is less than the amount credited to customers for overrecoveries and less, according to petitioner, than its current rate for short term borrowing. The Board is making no determination at this time on the appropriateness of any interest which may have been booked by Petitioner for underrecoveries for the months of September 2000 through April 2001. This issue will be revisited by the Board at a future date. The GCUA will be collected from all sales customers, and transportation customers who were sales customers, who were subject to the LGAC during all or part of the 2000-2001 LGAC period.

The Board further DIRECTS Petitioner to submit its 2001-2002 LGAC petition on November 15, 2001, with said petition to contain calculations in support of the proposed GCUA surcharge and the under-recovered balance to be collected from customers. Collection of the GCUA surcharge shall begin on December 1, 2001, but shall be provisional, subject to refund and interest, until the Board renders a final decision on Petitioner's 2001-2002 LGAC petition. In order to mitigate further rate increases, if Petitioner proposes to implement the GCUA surcharge without raising its LGAC billing factor beyond that set by this Order, the Board will permit Petitioner to increase its recoverable carrying costs on the GCUA amount to an annual simple interest rate of 5.75% as of December 1, 2001. The Board emphasizes that its actions concerning underrecoveries in this proceeding are based on extraordinary facts of this case and are not to be construed as a precedent in future proceedings.

In order to continue to mitigate the impact of rate increases on customers, the Board DIRECTS Petitioner to continue its consumer education and outreach efforts, and to implement the additional mitigation measures set forth in the November 2000 Order. The Board further DIRECTS Petitioner to include, in its consumer education and outreach efforts, information concerning the recently approved Comprehensive Resource Analysis of Energy Programs component for energy assistance to low income customers and the increased availability of NJ SHARES funding assistance.

With respect to the issue of whether Petitioner has adequate programs in place to protect ratepayers against the risk of future sharp fluctuations in wholesale natural gas prices, the Board DIRECTS Petitioner to submit a comprehensive hedging program to Board Staff and the RPA within 60 days of the date of this Order. The submission shall include specific information about how its hedging program will be managed and supervised. The financial and physical hedging strategies to be utilized shall be identified and Petitioner shall establish and fully describe a risk management committee authorized to review hedging activity on an ongoing basis. The Board further DIRECTS Petitioner to submit quarterly status reports to Board Staff and the RPA, identifying outstanding hedging positions and any changes to its hedging policy.

DATED: March 30, 2001

BOARD OF PUBLIC UTILITIES
BY:

(SIGNED)

HERBERT H. TATE
PRESIDENT

(SIGNED)

FREDERICK F. BUTLER
COMMISSIONER

I abstain from rendering a decision in this matter.

(SIGNED)

CAROL J. MURPHY
ACTING COMMISSIONER

ATTEST: (SIGNED)

FRANCIS L. SMITH
BOARD SECRETARY